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An Analysis of the Gap between Economic Incentives and Public Participation

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AN ANALYSIS OF THE GAP BETWEEN ECONOMIC INCENTIVES AND PUBLIC PARTICIPATION

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I HEREBY RECOMMEND THAT THE THESIS PREPARED UNDER MY SUPERVISION BY Rafael Ranieri ENTITLED An Analysis of the Gap Between Economic Incentives and Public Participation BE ACCEPTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF Master of Science in Social and Applied Economics.

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Abstract

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The objective of this study was to help clarify the reasons for the lack of public reaction to the corporate scandals that surfaced in the U.S. in the early twenty-first century. To this end, I assessed three possible avenues for preventing corporate malfeasance and reconciling the political economic system with social welfare. Among those I identified, public participation appears to be the most feasible. In this perspective, I analyzed four major factors that prevent individuals from engaging in corporate governance and in the political economic system in general. The findings indicate that so long as change depends upon the initiative of the status quo, there is little prospects for reconciling corporations and finance capitalism in general with social welfare.

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1. Introduction

The contradiction between corporate interest and social welfare is the determining factor in their interaction. Corporations develop at the expense of social welfare because their quintessential goal is to accrue pecuniary gains (Veblen 1904), a goal that is generally fulfilled more rapidly and with the greatest returns by exploiting society rather than following paths that favor the welfare of individuals and of the environment. The corporate scandals that surfaced in the United States in the beginning of the twenty-first century made evident this conflict between corporate interests and social welfare. Cases such as those of Enron and WorldCom imposed heavy burdens to shareholders, employees, and all those who interacted with these corporations either as business partners or as customers – excluding those individuals who were part of the schemes that caused the debacle of these corporations. Moreover, these cases unveiled the involvement of corporate managers, members of the board of directors, private and governmental oversight entities, as well as members of the polity in illicit measures to reap pecuniary gains at the expense of all other stakeholders. To the extent that this debacle included wide-ranging individuals and institutional involvement, it would be reasonable to expect fierce public reaction not only to the corporate scandals but also to the political economic system that nurtured them. However, there was little public reaction to these episodes and little change in the political economic system; that is, they "increased the public's distrust of corporate leaders but have yet to produce a significant change in public policy" (Champlin and Knoedler 2004: 551). The objective of this study is to help clarify the reasons for the lack of public reaction to the recent corporate scandals. This objective is informed by the understanding that the failure to respond to such episodes affects negatively the present and future socio-economic well-being of society.

As corporate scandals are economic phenomena, we must analyze corporate scandals as part of the U.S. economic system. In recent decades, the U.S. economy epitomizes the state of late modern capitalism in which financial transactions constitute a core feature. Given the controlling role of financial institutions, finance capitalism now substitutes for industrial capitalism in the U.S. and in other capitalist economies. Indeed, "[t]he financial resources that private financial institutions can bring into play in the world's money markets now dwarf even those of the most powerful governments" (Korten 1995: 201). To the extent that finance capitalism dominates economic relations, it shapes corporate behavior, and to the extent that corporations make efforts to shape the economic system to their benefit, corporations are responsible for the structuring and functioning of finance capitalism. I will argue that this self-reinforcing system, under which finance overrides production (Veblen [1904] 1959), is central to understanding the corporate scandals that recently surfaced within the U.S. economy.

Under finance capitalism, individuals are conceptualized as consumers. The system, in fact, pursues strategies to nurture individual as consumers and to disembowel any notion of citizenship. Accordingly, the neoliberal tradition within economics divides the economy in three sectors: households (consuming units), firms (producing units), and the government (the moderator between the other two units). In this study, I pursue an alternative conceptualization of the economy. Whereas the traditional conceptualization entails a de-humanizing perception of households, which are understood as economic units, namely consumers and/or suppliers of labor, I advance the conceptualization of the economy as constituted by citizens. The perception of individuals as citizens and not merely as consumers or suppliers of labor takes into account the notion that individuals are capable of participating in shaping and transforming the political economic system. This contrasts with the neoliberal conceptualization of individuals as passive actors who respond merely to prices and wages. The conceptualization of individuals as active citizens acknowledges the power individuals have to influence society and simultaneously vests in individuals the responsibility for shaping the political economic system to serve the public interest. Thus, conceptualizing individuals as citizens brings greater dynamism to the economy because it acknowledges that economic dynamism comes not only from the actions of firms or the policy decisions of the government, but also from citizens who have the ability to respond to socio-economic incentives and transform the political economic system in a way that favors social welfare.

To accomplish the objective in clarifying the reasons for the failure of individuals to respond to the recent corporate scandals in their role as citizens, I assess the effectiveness of the three potential avenues that could be used to prevent corporate malfeasance; namely, a moral transformation, government regulation and oversight, and public participation in corporate governance. In the next section, I begin by presenting the theoretical frameworks for understanding the recent corporate scandals. The third section presents my assessment of the avenues that could be used to prevent corporate malfeasance discussed above. The fourth section comprises an examination of the factors that constrain public participation in corporate governance and in the political economic system in general. The fifth section provides an overview of how public participation would make a difference in preventing corporate malfeasance and changing the political economic system. Finally, I present a conclusion based on my findings.

2. Corporate Scandals as Systemic Economic Phenomena

The corporate scandals that erupted in the U.S. in the beginning of the twenty-first century, such as the cases of Enron and WorldCom, can be seen as either symptomatic of the state of finance capitalism or as extraordinary cases. Whereas the scope of these cases indicates a systemic problem in the economy, there are those who believe that they are exceptions to the rule of an otherwise well-functioning economy. Therefore, an examination of the systemic nature of corporate malfeasance is in order.

Mainstream economics fails to provide a theoretical explanation for the corporate scandals represented by Enron and WorldCom. However, almost a century before the burst of these corporate scandals, Thorstein Veblen's theories of business enterprise (Veblen 1904 [1958]; 1908 [1969]) provided the means for analyzing the current state of finance capitalism in general, and corporate malfeasance in particular. Indeed, Veblen identified patterns taking root at the turn of the twentieth century that are pervasive in capitalist economies today.

Veblen contributed to the analysis of contemporary capitalist economies by identifying the central features of finance capitalism. By distinguishing between material and pecuniary capital and between earnings from productive activity and earnings from pecuniary activity, Veblen provided a theoretical framework that unlike neoclassical economic theory includes finance as a core feature of modern capitalism. Moreover, the exploration of economic phenomena beyond the sphere of production led Veblen to propose that business goals are not necessarily in line with productive activity. That is, Veblen proposed that the main objective of businesses in modern capitalist economies is pecuniary earnings rather than productive efficiency, wherein pecuniary activity will override productive activity whenever it works to the pecuniary advantage of businesses. These propositions are central for analyzing modern capitalist economies.

Another theoretical framework that is useful in analyzing corporate malfeasance is the agency problem (Coase 1937; Jensen and Meckling 1976; Fama and Jensen 1983). Originally conceptualized as a conflict stemming from the separation of ownership and control of businesses, the agency problem in modern capitalist economies refers to a conflict between the interests of managers and the interests of stakeholders without managing prerogatives. The agency problem is a systemic feature of finance capitalism because business management became a predominantly professional activity in modern capitalist economies.

In sum, both Veblen's theory of business enterprise and the agency problem involve core features of finance capitalism. Accordingly, I use both these theoretical frameworks analyze the systemic nature of corporate malfeasance in what follows.

2.1. Veblen's Theories of Business Enterprise

The major virtue of Thorstein Veblen's work about firms and the makeup of modern capitalist economies is that they comprise a theory of finance capitalism.[1] That is, Veblen's work is instrumental in analyzing modern capitalist economies because Veblen took into account the central role taken by finance in modern capitalism. Accordingly, for the purposes of this study Veblen developed the most appropriate theoretical framework for analyzing the modern capitalist system.

Veblen's work revolves around three conceptual distinctions. The first is the distinction between capital as material goods and capital as pecuniary assets. Material capital consists of machinery and equipment used in an industry's production process. These tangible assets are used to produce tangible goods for the consumer and producer markets. By contrast, pecuniary assets are capitalized intangible assets such as stockholdings, brand names or pecuniary expectations. Hence, pecuniary assets are sources of pecuniary wealth that do not relate to production. For instance, brand names are a source of pecuniary gain insofar as they provide brand-name recognition in the consumer and producer markets, thus increasing the value of the material output. The significance of brand-name recognition became more pronounced in modern capitalism with the development of hypercommercialization (Barber 1995). Likewise, the expectation of future earnings may increase the value of business enterprises, occasionally attributing a high value to even historically unprofitable businesses such as some Internet ventures. The recognition of the distinction between material goods and

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[1] Such works include *The Theory of Business Enterprise* (1904) and "On the Nature of Capital I & II" (1908).

pecuniary assets allowed Veblen to transcend the traditional conceptualization of business enterprise as limited to the sphere of production.

The second distinction Veblen made was between sources of profits. In the traditional conception, business profits are generated from the sale of material goods. In this tradition, profits are understood to depend upon the efficiency of production. To the conception of profits as the outcome of efficient production, Veblen added the notion of profits as gains from pecuniary assets. Hence, Veblen identified that firms can pursue returns on their investments not only by improving their productive efficiency, but also by pursuing gains from pecuniary assets.

Finally, Veblen distinguished the motivations of business enterprises. In the traditional conception, businesses attempt to maximize profits by making their production processes more efficient in both the economic and the technical sense or by improving their products. According to Veblen, firms attempt to maximize their profits irrespective of the means to attain that. In this perspective, firms will adopt non-optimal production techniques or direct their activities in a way that financial speculation overrides production whenever they can reap greater profits through such behavior than they would by focusing on improving their products and their production processes.

> "Except for the exigencies of investment, i.e., exigencies of pecuniary gain to the investor, phenomena of this character would have no place in the industrial system. They invariably come of the endeavors of business men to secure a pecuniary gain or to avoid a pecuniary loss. More frequently, perhaps, maneuvers of inhibition – advised idleness of plant – in industry aim to effect a saving or avoid a waste than to procure an increase of gain; but the saving to be effected and the waste to be avoided are always pecuniary saving to the owner and pecuniary waste in the matter of ownership, not a saving of goods to the community or a prevention of wasteful consumption or wasteful expenditure of effort and resources on the part of the community" (Veblen [1908] 1969: 354; quoted in Cornehls 2004: 33).

Analogously, as profit maximizers that are not concerned with the means to reap profits, firms attempt to maximize their profits regardless of the externalities generated by their production processes, such as air and water pollution, or by their products, such as health diseases. Firms may seek to optimize production, but other goals may be equally or more important. Whenever firms use non-optimizing production strategies such as sabotaging production or focusing on financial speculation to produce a maximum return on their investment, they stray from productive activity and social welfare.

Veblen's conceptual distinctions between the nature of capital, the sources of profits and the central goal of firms are foundational for understanding finance capitalism. These distinctions indicate that in the current capitalist system, the use of financial institutions is *sine qua non* of businesses. These are used either to secure profits, to harm competitor's profits, or to avoid losses from the financial activity of others. The use of financial artifices is critical because it allows firms to increase their profits by increasing the volume and rate of turnover of their capital stock. The increase in the capital stock via loan credit increases the amount of financial capital that firms have available (Veblen 1904: 50; cited in Cornehls 2004: 35). Larger amounts of financial capital enable firms to either pursue opportunities otherwise financially unattainable or pursue a greater number of business transactions, thereby strategically improving the financial strength (or reducing the financial constraints) of firms in a way that both productive and financial activities may be benefited. In addition, a larger capital stock increases the size of pecuniary revenues, which increases total revenues in a way that the overall financial performance of firms appears more favorable within financial markets. That is, a larger amount of financial capital can increase the size of revenues, thereby making businesses appear more successful – especially when the size of profits also increases – implying greater financial strength. In turn, greater financial strength confers greater creditworthiness, allowing firms to continue borrowing and engaging in financial speculation.

The increase in the volume of the capital stock via loan credit is also in the interest of firms for increasing their rate of turnover. The rate of turnover is central because the time that it takes to recover investments affects the rates of return on investment. The availability of larger amounts of financial capital not only enables firms to increase their number of business transactions but the pace of transactions as well, thereby increasing the turnover of financial investments.

The potential loss from failing to use loan credit to pursue pecuniary gain is as compelling as the potential benefits. Essentially, firms that increase their capital stock via loan credit gain a financial advantage over firms that do not because it: a) increases their ability to make productive or pecuniary investments, b) allows them to sustain lower prices, and c) provides them with greater access to more loan credit. A greater ability to make investments enables firms to improve their productive efficiency or the quality of their financial holdings. In the case of productive investment, this allows for greater productivity and lower production, distribution and commercialization costs and greater pecuniary revenues. Lower costs resulting from gains in productivity allow firms to offer lower prices. Larger capital stocks also allow firms to sustain price reductions by providing a larger cushion for the purposes of cash flow. Hence, loan credit allows firms to offer lower prices and undersell those competitors that do not follow the same pattern, thereby generating gains in market share over those that remain financially weak. By contrast, firms that abstain from or are unsuccessful in their use of loan credit reduce their ability to gain market share and pecuniary revenues.

By force of the incentives for using loan credit, firms are compelled to "borrow as much as [their] creditworthiness and the state of the market will allow" (Cornehls 2004: 35). Insofar as the rate of earnings exceeds the interest rate on loans, firms have incentive to continue borrowing as much as possible. Consequently,

> "...by the use of loan credit the nominal volume of assets (physical capital and capitalized values) is increased until such a point as the paper value of assets is out of proportion to the earning capacity of the corporation, in which case it must undergo a major retrenchment, liquidation, or acquisition by another business entity" (Veblen 1904: 58-59; cited in Cornehls 2004: 36).

Nonetheless, a voluntary retrenchment is unlikely to happen because it conflicts with the goal of maximizing profits without concern for the means to do that. Hence, as long as the market provides opportunities for firms to continue benefiting from financial speculation, firms will continue increasing their capital stock even when they knowingly bear unsustainable situations. The reckoning occurs when creditors perceive or become concerned with the gap between the earning capacity and the nominal value of assets of a business and deny further credit as well as demand to receive what is owed to them. The extinction of credit affects a firm's cash flow, critically reducing its ability both to operate and to honor its financial responsibilities. In addition, fearing that they will not receive their money back, creditors demand to be paid what they are owed promptly, an attitude that further distresses firms that are already struggling because of the disruption of their cash flow. Such situation leads to liquidation, which causes either a transfer of ownership from owners to creditors, a merger or an acquisition by other firms.

According to Veblen's theory of finance capitalism, the business cycle in contemporary capitalism entails a period of speculative prosperity and a period of retrenchment or adjustment. The impact of this process on the economy ranges from the concentration of economic power through mergers and acquisitions to higher unemployment with the dismissal of workers from firms that are liquidated or acquired by other business entities. Overall, the outcome of the process is a dramatic reduction in social welfare.

Mergers and acquisitions prompted by the collapse of firms that relied on financial speculation have the effect of making firms that are financially strong even more powerful by further concentrating market power. Thus, those firms that are able to remain financially strong have their monopolistic prerogatives enhanced. At the same time, the barriers for new entrants and the challenges for smaller firms grow. Consequently, small firms tend to go out of business, generating further concentration of market power and greater socioeconomic distress because not all of their workers are absorbed by the remaining firms. In turn, the increase in the number of idle workers affects aggregate demand by putting downward pressure on both wages and the aggregate employed workforce. In addition, such business consolidations usually fail to accrue improvements in efficiency because oftentimes "...the purpose of these acquisitions has nothing to do with improving the industrial or service efficiency of the acquiring enterprise but with amassing businesses with a view to expand the use of credit and to inflate the stock price of the acquiring corporation" (Veblen 1904: 28-29; cited in Cornehls 2004: 36). Furthermore, the collapse of businesses due to the curtailing of speculative prosperity harms investor confidence, thereby reducing investment.

Ultimately, when the collapse of a few major business entities coincide, they are likely to trigger an economic crisis (Mitchell [1936] 1964: xliii-xli; Raines and Leathers 1996: 141; cited in Cornehls 2004: 37).

Therefore, the final outcome of the cycle of speculative prosperity that is endemic to finance capitalism is greater concentration of economic power and lower levels of social welfare. That is, the dialectics of finance capitalism cause greater income and wealth inequality by further concentrating economic power and disrupting the livelihoods of workers unemployed by firms that are liquidated or acquired by other businesses. An indication of this pattern is the growth of the income inequality gap in the U.S. during the speculative boom of the 1990s. Indeed, the Gini coefficient of income inequality went from 0.428 in 1990 to 0.46 in 2000, and the average level of income inequality in the 1990s is significantly worse than that in the 1980s. [2] In addition, the economic downturn of the first years of the twenty-first century experienced a pattern of expected economic decline following a period of speculative prosperity. Such decline in economic activity included, among other factors such as terrorism, the complete collapse of major corporations such as Enron and WorldCom as well as Enron's auditor Arthur Andersen, supposedly one of the major gatekeepers of the system.

The U.S. economy in the 1990s and the early twenty-first century exemplifies the cycle of finance capitalism theorized by Thorstein Veblen. During the 1990s, "corporations … borrowed huge sums from lenders, issued new stock, and acquired or were acquired by other corporations in industrially meaningless acquisitions and mergers which served only to inflate the paper values of these enterprises"(Cornehls 2004: 37). In this period, corporate management focused on the possibility of increasing the value of stocks by promoting mergers and acquisitions. The purpose was to appeal to the financial markets irrespective of actual gain in productive efficiency, a practice that is well represented by the AOL Time Warner merger. Whereas corporate managers, the boards of directors and the wealthiest stockholders benefited from such practices (DeCarlo 2002), concomitantly the economy experienced a period of apparent prosperity during which time corporate assets were capitalized within a feeling of quasi-euphoria. Nonetheless, the U.S. economy was in fact absorbing the burdens of this misallocation of resources in the form of growing income and wealth inequality and a latent inability to sustain the speculative mood. As a result, the 1990s hosted numerous forgone opportunities of constructive resource allocation.

By the turn of the twenty-first century, a number of corporate scandals surfaced involving "outright chicanery and fraud with the complicity of allegedly independent auditors, shady stock brokers, cooperative lawyers, and avaricious banks"(Cornehls 2004: 37). Enron and other corporations such as WorldCom not only used loan credit to project themselves as successful enterprises and enrich their top managers and their boards of directors, but they also used financial and accounting trickery to deceit the market about their actual financial health. These corporations "were trying to stay ahead in the game of finance capitalism and the use of loan credit demanded by the capitalist system" (Cornehls 2004: 37).

The debacles of both Enron and WorldCom illuminate Veblen's theory of business enterprise within finance capitalism. Both corporations promoted aggressive capital expansions via loan credit, becoming financial titans while ignoring their productive activities. When they reached a point in which they exhausted their

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[2] Difference of mean values tested through t-statistics test at the .05 level of significance.

possibilities of financial speculation and thus needed to experience retrenchment, Enron and WorldCom used illicit maneuvers to hide their unsustainable debt in order to continue their capital expansions. When creditors eventually refused to extend credit, Enron and WorldCom crumbled, revealing their accounting and financial swindles. Ultimately, both went bankrupt, causing transfers of ownership from shareholders to creditors, extensive layoffs, and as their stocks plummeted, massive losses to pension funds and savings accounts. Moreover, while Enron and WorldCom collapsed, their top executives walked away well-endowed. For instance, "[o]n the eve of bankruptcy and in the wake of the layoff of 24,000 employees in 2002 (17,000 of them on a single Friday afternoon in July) the top executives [of WorldCom] nevertheless received bonuses of more than $ 100 million in anticipation of the bankruptcy filling"(Cornehls 2004: 40).

The episodes of Enron and WorldCom illustrate how recent corporate scandals fit a systemic pattern rather than constituting exceptions to the rule. They adhere to the underlying premise of Veblen's theory of finance capitalism, and although Veblen did not address the question of illicit behavior directly, the scope of their illicit activities indicates a systemic flaw in finance capitalism as envisioned by Veblen. Notably, "[t]he Enron failure is the biggest political scandal in American history [...], it is the biggest scandal ever to hit Wall Street [...], it is the biggest scandal to ever hit accounting [...], [and it is] the most egregious example of executive piracy in American corporate history" (Bryce 2002: 5-7). Hence, Enron's debacle involved the major institutions across the U.S. political economic system. It "...was not a result merely of commercial misfortune or personal crookedness. The collapse was possible only because of flaws in the way that

American capitalism has worked ...."[3] In addition, "[t]he other obvious deformity exposed by Enron is the insidious corruption of democracy by political money."[4]

The extent of the involvement of Enron's boards of directors, of its supposedly independent auditors, of stock brokers and brokerage firms, corporate lawyers, of financial institutions and of the government indicate that the practices that caused Enron's debacle are not limited to "a few bad apples" but are instead endemic to finance capitalism. Many other corporations, including Adelphia Communications, Cedant, CMS Energy, Dollar General, Duke Energy, Dynegy, Global Crossing, HPL Technologies Inc., Merck & Co., Microstrategy, Sunbean, Tyco Intl. Ltd., Vivendi Universal, Waste Management and Xerox, showed similar patterns.[5] This underscores the pervasiveness of "pecuniary interest" over concerns of productive efficiency and promotes an understanding that corporate scandals are systemic economic phenomena rather than extraordinary cases in modern capitalist economies such as the United States.

[3] "The twister hits" *The Economist* (January 19th 2002), p. 57.
[4] Greider, William, "Crime in the Suites," *The Nation* (February 4, 2002), (http://www.thenation.com/doc.mhtml?i=20020204&s=greider)
[5] From Citizen Works - The Corporate Scandal Sheet (http://citizenworks.org/enron/corp-scandal.php)

2.2. The Agency Problem

The agency problem, also known as the principal-agent problem, stems from the separation of business ownership and management of business organizations. The delegation of management to professional managers, a systemic practice in publicly traded businesses, vests managers with prerogatives over the productive and financial operations of corporations that ordinary shareholders do not have. That is, managers have direct power over corporate activity and ordinary shareholders do not. This distinction provides managers with great discretionary powers, making them considerably independent from shareholders. Such independence allows managers to pursue objectives that differ from those of shareholders. Thus, the systemic practice of delegating corporate management to individuals with enormous control over business operations imposes a potential risk for shareholders.

The separation of ownership from management is an intrinsic feature of corporations because of the dispersion of ownership in publicly traded shares of the corporation's (material and financial) capital stock. Corporations usually have numerous shareholders; hence, it is virtually impossible for all of them to be simultaneously and directly involved in managing the corporation. Besides, it has become commonplace in the capitalist mindset that stock ownership constitutes an opportunity of sharing the gains (or the risk of bearing the losses) that a corporation might accrue with little or no involvement beyond the financial input inherent to the acquisition of stocks. In this perspective, the majority of shareholders are willing to take the risks of investing, but they do not desire to be directly involved in managing the corporations of which they own stocks.

> "Indeed, portfolio theory tells us that the optimal portfolio for any investor is likely to be diversified across the securities of many firms. Since he holds the securities of many firms precisely to avoid having his wealth depend too much on any one firm, an individual security holder generally has no special interest in personally overseeing the detailed activities of any firm. In short, efficient allocation of risk bearing seems to imply a large degree of separation of security ownership from control of a firm" (Fama 1980: 291).

Furthermore, because shareholders have interest in obtaining the maximum gains they can possibly get from their stockholdings (either from the valorization of their stocks or from dividends they receive), they have an added interest in having experts hired to manage corporations. Therefore, the configuration of business enterprises as corporations inherently generates the separation of ownership from management. Corporations account for 89.5% of total business revenues in the U.S.;[6] hence, their economic significance makes the separation of ownership from management control of businesses a pervasive feature in the U.S. and other contemporary capitalist economies.

Whereas the capitalist system imposes a risk to shareholders by encouraging the separation of ownership from management control, it does not automatically generate a problem. The system does give managers ample opportunity to favor their own objectives and stray from the interests of shareholders, but it is ultimately up to managers whether they take this opportunity. Thus, the agency problem refers to the challenge of guaranteeing that managers forfeit this opportunity of managing for personal gain heedless of the interests of shareholders. In a more traditional conception, the agency problem involves the challenge for investors to guarantee "… that their funds are not expropriated or wasted on unattractive projects" (Shleifer and Vishny 1997: 741).

[6] From the U.S. Bureau of the Census 1998 Statistical Abstract.

The agency problem materializes when managers' interests conflict with the interests of shareholders, and managers favor their interests over those of shareholders. The conflict between the interests of managers and shareholders does not stem from mere self-interest of managers, but from greed. Corporate managers are rewarded extremely well for their managing expertise, and their job description allocates such expertise to generating the maximum pecuniary gains for shareholders. In this perspective, by fulfilling their job description, managers justify their prince-like remuneration and build their reputation in their professional niche. Hence, under normal circumstances managers' self-interest align with the pursuit of what is best for shareholders. However, managers whose behavior deviates from the duty of providing to shareholders the maximum pecuniary gains from their stockholdings are not motivated by self-interest; they are motivated by greed or disorders of ego. Indeed, among other reasons, "Enron failed because its leadership was morally, ethically, and financially corrupt" (Bryce 2002: 12). For instance, Jeff Skilling "… was never thinking of anything other than how to enhance his paycheck" (Bryce 2002: 66), and Rebecca Mark "was every bit as cunning and every bit as vain in her quest for power, fame, and mountains of money" (Bryce 2002: 95). Enron's leaders were skilled in exploiting the connivance of a corrupt system, but they were also byproducts of this system that equates success to material gain and ostentation, as well as to the social status ascribed by those.

Managers can misuse their managing control in many ways. The corporate scandals that surfaced in the U.S. by the turn of the century involved, among other means of malpractice, the use of financial and accounting swindles to boost stock values and increase gains from the exercise of stock options, the appropriation of money through ventures controlled by managers which also served to hide debt, and the wasteful use of corporate resources in pet or irrational projects. At Enron, Andrew Fastow's financial engineering created LJM Cayman, LP (LJM1), and LJM2 Co-Investment, LP (LJM2), investment partnerships that "… were implemented improperly to offset losses. They permitted Enron to conceal from the market huge losses resulting from merchant investments by creating the illusion that they were hedged" (Vinten 2002: 5). These financial entities deceived the market into believing that third parties bore Enron's losses, but in fact, Enron was financially responsible for them. Besides, Fastow "received more than $30 million from LJM1 and LJM2" (Vinten 2002: 5). In addition, Fastow created another related party entity, Chewco Investments, LP, which was managed by one of his employees, Kopper, who "received at least $30 million" (Vinten 2002: 5) for his role in the scheme for hiding Enron's ailing situation. Furthermore, it is outrageous "how much [Kenneth] Lay and his colleagues made from Enron shares, unlike their workers, whose pension funds were largely invested in Enron stock that they were unable to sell in time."[7]

Examples of financial exploitation practiced by managers are abundant. Adelphia Communications allegedly made multibillion, off-balance sheet loans to its founders, the Rigas family, whose members happened to occupy the positions of CEO and CFO of Adelphia.[8] HPL Technologies, Inc. used 'creative accounting' to inflate stock prices in a way that executives were able to sell stock at inflated prices.[9] Disney's Michael Eisner has resisted leaving office against substantial shareholder interest in his departure. These

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[7] "The real scandal," *The Economist* (January 19th 2002), p.9

[8] From Citizen Works – The Corporate Scandal Sheet <http://www.citizenworks.org/enron/corp-scandal.php>

recent episodes and many others alike, provide strong evidence that the agency problem is pervasive in the corporate world.

The potential losses as a result of the agency problem encourage shareholders to adopt measures curtailing the discretionary powers of managers. Theoretically, the most straightforward way of guaranteeing that managers serve only shareholders is specifying in the management contract limited prerogatives to each particular situation possibly related to the corporation. However, there are two critical problems with this solution. First, it is virtually impossible to foresee all possible situations that a manager might have to cope with in the future. Hence, it is impossible to put in writing specific guidelines that assure that managers behave according to the interests of shareholders at every instance of the corporation's life. Second, a contract does not guarantee that managers will abstain from illicit activities. Thus, corporations employ alternative solutions in the attempt to mitigate the agency problem.

In an attempt to solve the problems related to writing a contract that fully specifies the prerogatives of managers in a way that the interests of shareholders are safeguarded, management contracts "… allocate residual control rights – i.e., the rights to make decisions in circumstances not fully foreseen by the contract (Grossman and Hart 1986, Hart and Moore 1990" (Shleifer and Vishny 1997: 741). Essentially, residual control rights reserve discretionary power to investors or shareholders in situations that are not covered by the management contract. Such control rights theoretically allow investors or shareholders to curb management discretion. However, in practice, managers usually end up commanding the residual control rights. Managers usually have more

[9] From Citizen Works – The Corporate Scandal Sheet <http://www.citizenworks.org/enron/corp-scandal.php>

expertise than investors or shareholders to deal with the affairs of the corporation. Thus, they are better prepared than investors or shareholders to deal with unforeseen circumstances. Besides, contracts are seldom enforced in courts-of-law because "… the so-called business judgment rule [normally] keeps the courts out of the affairs of companies" (Shleifer and Vishny 1997: 741). Furthermore, in most cases shareholders and "investors are often small and too poorly informed to exercise even the control rights that they actually have" (Shleifer and Vishny 1997: 741).

A typical way of trying to mitigate the potential problems inherent to the separation of ownership from management control of corporations is the use of incentive contracts entailing stock options. The logic behind making stock options a substantial part of executive pay is to tie executive remuneration to the performance of the corporation's stock in a way that it is in the pecuniary interest of managers to pursue the maximum valorization of the corporation's stock. Although logically consistent, incentive contracts have shortcomings that stem from the very forms of incentives they normally involve, namely stock options. "It is pointed out that options encourage executives to try to increase short-term profits in order to increase the value of their options, at the expense of long-term growth and stability" (Cornehls 2004: 48; citing Fox 2002). Besides, stock options might be an incentive for managers to boost the value of a corporation's stock through illicit means such as financial and accounting trickery, a behavior that has surfaced as a predominant practice in the U.S. corporate environment. Thus, because of the lack of an appropriate solution, the agency problem remains a challenge for finance capitalism.

The systemic demands of finance capitalism are harmful to social welfare. Given the reach of corporations in an increasingly integrated world, the impact of corporate activities transcend national boundaries and involve numerous groups and environments across the globe. Corporate malfeasance and its ramifications are global phenomena as opposed to "merely an American affair …. [They are] an apt illustration of the consequences of the rush to embrace a corporate-sponsored template for economic liberalization: from multilateral free-trade pacts that supersede domestic regulations to privatization, deregulation, [IMF]-ordered 'structural adjustments' of national economies and the corrupting interplay of corporate campaign contributions and policy-making that is no longer just a US phenomenon."[10] The agency problem further diverts corporate activity from the interests shared by groups of socioeconomic actors. Therefore, the agency problem worsens the global impact of corporations as the central institutions of finance capitalism.

[10] Nichols, John, "Enron's Global Crusade," The Nation <http://www.thenation.com/doc.mhtml?i=20020304&s=nichols>

3. Reconciling Corporations and Social Welfare

As previously argued, corporate scandals are symptomatic of finance capitalism rather than extraordinary cases. The reason corporate scandals might appear to be extraordinary cases is the dearth of media coverage of such economic phenomena. As a consequence of the concentration and interconnections of the corporate news media, "the corporate sector is increasingly exempt from any sustained critical examination from a *public interest perspective*" (McChesney 1999: 58). Indeed, the Enron scandal appeared on the media only while it remained in the condition of a "new" news-hook. In general, contrary to its systemic nature and thus to its pervasiveness, corporate malfeasance goes unreported. This in part explains why the corporate scandals of the early twenty-first century failed to generate a social movement for corporate reform in the U.S. Analogously, this partially explains the lack of interest in reforming finance capitalism in general.

The purpose of this paper is to explore why the recent corporate scandals, as symptoms of systemic economic problems, were not turning points in terms of generating serious corporate reforms. In other words, I am interested in why there was no public reaction to corporate scandals when it clearly was in the economic interest of the public to react. Corporations are central institutions of finance capitalism; hence, the answer to this question also addresses why there is little concern about the evident malaises of finance capitalism in general. The interest in finding the answers to these questions is ultimately connected to an interest in understanding social phenomena and in generating progressive reforms.

The consequence of corporate malfeasance is to further disunite private and social welfare. That is, by benefiting very narrow interests at the expense of the social good, corporate malfeasance widens the gap between haves and have-nots. Thus, corporate reform is in need to reconcile corporate activity with social welfare.

There are three factors that could have prevented corporate scandals from happening: 1) a moral dogma that put the collective before the self; 2) effective government regulation and oversight; and 3) the participation of the public in corporate governance in a way that made corporations align with the public interest. Evidently, because corporate scandals occurred these three factors are lacking. In this perspective, corporate reform depends upon overcoming their absence. That is, preventing new corporate scandals such as those involving Enron and WorldCom depends upon a drastic moral transformation of society, tighter government regulation and oversight, and/or the engagement of civil society in overseeing corporate activity. Any of these has the potential to promote productive rather than pecuniary activity, legal rather than disruptive or illicit behavior, as well as socially-responsible rather than greedy behavior. Although these factors are complementary, in what follows I assess which of these has a greater ability to generate corporate reform.

3.1. On the Possibility of Moral Transformation

For purposes of this paper, I will argue that individualism coupled with greed is one of the main determinants of the recent corporate scandals, the deleterious consequences of finance capitalism, and society's malaise. I will also argue that most contemporary problems can be solved by substituting concern for self with concern for the collective. Nonetheless, I recognize in what follows that it is unrealistic as it is simplistic to assume that a moral transformation on the scale necessary to generate corporate reform will be forthcoming in the foreseeable future.

The moral dogma underlying finance capitalism provides justification for individualism and greed. The set of principles underlying the political economy of capitalist societies and most prominently espoused in mainstream economics provide the "social justification for the untrammeled, uninhibited pursuit and possession of wealth [by attributing to it a] social purpose" (Galbraith 1992: 96-97). In this perspective, outrageous material compensation serves to offset the risks inherent to entrepreneurship in a way that society can benefit from the dynamism of an otherwise weak economy. In addition, the neoclassical economic mantra embeds the underlying assumptions that people are naturally driven by greed, that consumerism is innate to humans rather than constituting a systemically promoted behavior, and that human behavior, following from the first two assumptions, ultimately generates socially positive outcomes. These assumptions have "... become so deeply embedded within our values, institutions, and popular culture that we accept [the self-justifying ideology that they support] almost without question" (Korten 1995: 71). Furthermore, capitalism systemically provides perverse incentives for greedy behavior.

Capitalism's consumer society exploits the human need for interaction to fulfill physical and emotional needs by catalyzing such needs into material needs through status comparisons. The combination of the attribution of social status to material wealth and its ostentation, which is a core feature of capitalism's consumer societies, with the social aspects of human beings, encourages status comparisons and conspicuous consumption (Veblen [1899] 1998). This materialistic conception of personal fulfillment encourages greed in a way that it is continuously reinforced in the cycle of "keeping up with the joneses." Thus, the social pressure to emulate mitigates identification with the collective.

Without concern for the collective, greed becomes pervasive and favors corporate malfeasance. The systemic promotion of self-interest and greed provide ample room for undermining social welfare. For instance, Enron was consistently "… cited in reports on human rights and environmental abuses produced by groups like the Human Rights Watch, Amnesty International, CorpWatch, *Multinational Monitor* and Friends of the Earth."[11] A moral transformation of society from a morality rooted in greed to one that promotes altruism could prevent the occurrence of episodes such as those epitomized by Enron by bridging self-interest and the concern for the collective. Such transformation could not only mitigate corporate malfeasance, but also realign economic activity with social welfare. However, because of the pervasiveness of the consumer culture within global finance capitalism, self-interest and greed are becoming dominant features of increasingly more societies globally. This reduces the possibility of a moral transformation not only in the United States, but worldwide.

[11] Nichols, John, "Enron's Global Crusade," *The Nation* <http://www.thenation.com/doc.mhtml?i=20020304&s=nichols>

3.2. On the Possibility of Effective Government Regulation and Oversight

The underlying premise of government regulation and oversight is that if they are left alone, firms will engage in activities that might be deleterious to other firms and to society as a whole. Such potential behavior demands that the government perform the role of mediator and supervisor of economic interactions. Hence, government regulation and oversight has the objective of limiting both the range of action of managers and corporations and reducing the possibility of violating the regulated boundaries and getting away with it. This means strong regulatory bodies must determine through regulatory legislation the rules under which each business branch must operate, must provide strong oversight which checks rule compliance, and must punish violators.

Government regulation and oversight is the most commonly used method to secure fair and equitable relationships between individuals in the marketplace. Theoretically, efficient government regulation and oversight of corporate activity could curtail corporate malfeasance and consequently promote greater social welfare. However, its efficiency depends upon total government independence from corporations, a critical requirement that the recent corporate scandals made clear is lacking in the U.S. today.

The growing collusion of the government and corporations has been increasingly defiling the theoretical role of the government as an independent mediator of socio-economic interactions. Traditionally, government was expected to make the rules that regulated the economy and firms were expected to comply with the rules as part of the duty and responsibility of doing businesses. However, increasingly more government rules and policies are shaped by corporations in a way that makes them consistent with the profit generating ventures of corporations. For instance, article 1110 of NAFTA's chapter 11 provides investors with prerogatives to file claims against any member country whose regulatory policies actually or potentially diminish the profits expected by corporations.[12]

The mitigation of corporate malfeasance through government regulation and oversight is not viable so long as finance capitalism commands the polity through the many avenues of money-politics. "The market ideology has produced the best government that money can buy. The looting is unlikely to end so long as democracy is for sale."[13] In a political economic system in which political power derives from and answers to economic wealth, campaign contributions and powerful lobbies align policymaking, government action, and law enforcement with the interests of corporations. Nonetheless, campaign finance, lobbying efforts, and other obvious links between lawmakers and corporations (such as participation of former representatives on the boards of corporations that they helped while in office) are not the only means of binding corporations and the polity. The polity also caters to corporate interests through the employment of government resources to promote corporate activity within and beyond national borders. For instance, the taxpayer funded "... OPIC [Overseas Private Investment Corporation] and the Export-Import Bank loaned Enron $2.4 billion for its international projects"[14] after private institutions and even the oftentimes pro-global corporations World Bank denied support because such projects were considered not economically viable. In another example of misuse of government resources in collusion

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[12] "NAFTA Chapter 11 Investor-to-State Cases: Bankrupting Democracy," *Public Citizen* <http://www.citizen.org/documents/ACF186.PDF>

[13] Greider, William, "Crime in the Suites," *The Nation* <http://thenation.com/doc.mhtml?I=20020204&s=greider>

[14] Nichols, John, "Enron's Global Crusade," *The Nation* <http://www.thenation.com/doc.mhtml?i=20020304&s=nichols>

with corporations, "[t]he Clinton Administration threatened to cancel development aid to Mozambique if the country did not accept the plan to have Enron construct a pipeline to South Africa."[15]

Another barrier to effective government oversight of the marketplace is that no matter how rigid regulations and oversight might be, capitalist actors that are greedy enough to be willing to sabotage the system will always find ways to get around regulations and oversight. Consequently, at this point in time, governmental control is incapable of solving the conflicts within modern capitalism.

[15] Nichols, John, "Enron's Global Crusade," *The Nation* <http://www.thenation.com/doc.mhtml?i=20020304&s=nichols>

3.3. On the Possibility of Public Oversight

The engagement of the public in policing corporate behavior appears to be as unrealistic as government oversight; perhaps even less viable. This perception stems from the statistical evidence, discussed below, that the American public is politically apathetic. The public was also politically passive in light of the recent corporate scandals, demonstrating little public reaction or debate about the nature of corporate governance. From a general perspective, such public passiveness in relation to economic institutions might be attributed to three main factors. First, only a limited number of people own stocks. The majority who do not own stocks have little incentive to participate, because they do not have direct economic ties to the corporations in question. Second, the lack of interest among pension holders is understandable because they rely on outside agents to invest their pension funds in the stock market and consequently, often fail to understand the relationship between stocks and pension funds. Third, the majority of the public often lack basic knowledge about how to analyze a corporation's financial statements in particular and the operations and governance of corporations in general. Thus, there are several limitations to public engagement and the direct oversight of corporate behavior.

Clearly, public passiveness and apathy encourages further economic exploitation. That is, if corporations perceive that the public will not react to their illicit behavior, they have little incentive to change their behavior. As a result, the public continues to pay the cost of corporate malfeasance. Accordingly, we would expect investors and society at large to take an interest in policing corporations because of this cost. It is also logical to expect that shareholders would closely monitor the behavior of corporate entities because their money is invested in the corporations in question. In particular, investors have a greater incentive to ensure that managers do not expropriate or waste their funds. Analogously, the public's oversight of corporations is expected because corporations have a vast impact on people's living and working conditions, from the installation of plants to the production process to the final goods produced. Society also has an interest in seeing that resources are allocated in the collective interest rather than for the benefit of the few -- that corporations pursue tangible rather than pecuniary gains and promote social rather than private welfare. If investors and the public at large fulfilled their expected roles to protect their respective interests the two-dimensional disconnection within finance capitalism (shareholders/managers; civil society/corporations) would be solved. In addition, public participation is the necessary condition for resolving this problem because unlike the government, which often sides with corporations against the public (Korten 1995), the public has a direct incentive to get involved as workers, investors, and as citizens who can no longer rely on the government for corporate oversight. The Enron debacle provides a case in point. For instance, as the value of Enron's stock fell abruptly because of the unfolding of its misdoings, "... ordinary Americans – the beneficial owners of pension funds – lost $25-$50 billion because they were told lies by the people and firms they trusted to protect their interests."[16] Indeed, "[t]he day Enron filled for bankruptcy its stock closed at 72 cents, down from more than $75 less than a year earlier. Many employees lost their life savings and tens of thousands of investors lost billions" (Vinten 2002: 5).

[16] Greider, William, "Crime in the Suites," *The Nation* <http://thenation.com/doc.mhtml?I=20020204&s=greider>

Reasons for Public Participation

Public passiveness in response to the recent corporate scandals is difficult to understand because there were compelling reasons for public reaction. To begin, "Long-term capital management (LTCM) … created a trillion dollar hole in the international banking system" (Vinten 2002: 4; citing Lowestein 2001). Enron's debacle not only caused investors and pension-holders to lose billions of dollars and eliminated numerous jobs, but it also included a liability of $1 billion to taxpayers through the OPIC.[17] In addition, Enron's global expansion caused harmful environmental impacts and included human rights violations in countries such as India, Brazil and Mozambique.[18] The retrenchment of the AOL Time Warner media merger caused substantial layoffs on top of a 13% reduction in the workforce right after the merger (Cornehls 2004). Finally, as envisioned by Veblen, "[b]ankruptcies, precipitous declines in share prices, forced liquidations, major banking losses, and, of course, huge employee layoffs by the mismanaged corporations all helped to fuel the [2001-2003] economic crisis" (Cornehls 2004: 43).

Another way of assessing the impact of corporate malfeasance and finance capitalism in general on the well-being of the population is to look at the increase in the income gap in the United States in recent years. Indeed, when we examine the U.S. Gini coefficient as a measure of income inequality, there is evidence of a significant increase in the inequality gap, including a considerable leap during the 1990s speculative boom.

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[17] Nichols, John, "Enron's Global Crusade," *The Nation* <http://www.thenation.com/doc.mhtml?i=20020304&s=nichols>

[18] Nichols, John, "Enron's Global Crusade," *The Nation* <http://www.thenation.com/doc.mhtml?i=20020304&s=nichols>

This evidence suggests that corporate behavior and the state of modern capitalism undermines social welfare. Comparing the mean Gini coefficients for subsequent periods of five years from 1967 to 2001, it is clear that with the exception of the late 1960s and early 1970s, and the mid- to late 90s, each period is significantly different from the previous period. Since the coefficients follow an upward trend, and the greater the coefficient the more skewed the distribution of income, these findings indicate a pattern of significant worsening of the distribution of income in the U.S. since 1967. Table 3.1 below summarizes these findings:

Table 3.1: Testing for differences in Gini Coefficients for income inequality (5 years periods) [19]

Periods Compared	T-critical	T-statistics
(1967-71) vs. (1972-76)	2.45	1.69 (not significantly different)
(1972-76) vs. (1977-81)	2.45	3.9 (significantly different)
(1977-81) vs. (1982-86)	2.45	7.91 (significantly different)
(1982-86) vs. (1987-91)	2.45	7.12 (significantly different)
(1987-91) vs. (1992-96)	2.45	4.01 (significantly different)
(1992-96) vs. (1997-01)	2.45	1.87 (not significantly different)

An absolute worsening of the income distribution is, in and of itself, an incentive for reacting against the economic system behind it. However, if the income distribution worsens gradually between subsequent periods in a way that individuals are not able to

[19] Two-tail tests ($\alpha = 0.05$)
H_0: $\mu 1 = \mu 2$; H_a: $\mu 1 \neq \mu 2$

apprehend, we would expect little public reaction. According to the results showed in Table 3.1., there are significant differences in the income distribution in the U.S. between small subsequent time-periods. That is, the worsening trend in income distribution in the U.S. has not been, for the most part, too subtle to be noticed. Thus, it should have given incentive for public participation.

Perhaps part of the explanation for the lack of public participation is the fact that when we reduce the time-period to smaller units, differences in income distribution are less apparent. Table 3.2 below shows the differences in the Gini coefficients of income inequality between three-year time-periods. As indicated, there were mixed results:

Table 3.2: Testing for differences in Gini Coefficients for income inequality (3 years periods)[20]

Periods Compared	T-critical	T-statistics
(1969-71) vs. (1972-74)	4.3	2.6 (not significantly different)
(1972-74) vs. (1975-77)	4.3	-0.7 (not significantly different)
(1975-77) vs. (1978-80)	4.3	4.9 (significantly different)
(1978-80) vs. (1981-83)	4.3	1.89 (not significantly different)
(1981-83) vs. (1984-86)	4.3	2.21 (not significantly different)
(1984-86) vs. (1987-89)	4.3	4.6 (significantly different)
(1987-89) vs. (1990-92)	4.3	3 (not significantly different)
(1990-92) vs. (1993-95)	4.3	27 (significantly different)
(1993-95) vs. (1996-98)	4.3	0.89 (not significantly different)
(1996-98) vs. (1999-01)	4.3	0.6 (not significantly different)

[20] Two-tail test ($\alpha = 0.05$)
$H_0: \mu 1 = \mu 2$; $H_a: \mu 1 \neq \mu 2$

Seventy percent of the three-year period comparisons indicated that there is no significant difference between income distributions. These include the late 60s to mid-70s, the early to mid- 1980s, the early 1990s, and the late 1990s to the beginning of the twenty-first century. However, the time-periods that showed significant differences in income indicate that there were three periods of apprehensible worsening of the income distribution in the U.S. between 1969 and 2001. The latter somewhat corroborates the earlier findings that there were significant leaps in income redistribution from 1972 onward. Hence, the worsening of the distribution of income in the U.S. suggests that the public had incentive to react. Nevertheless, there is considerable evidence that the public remains apathetic even though the income gap is directly related to their own self-interest.

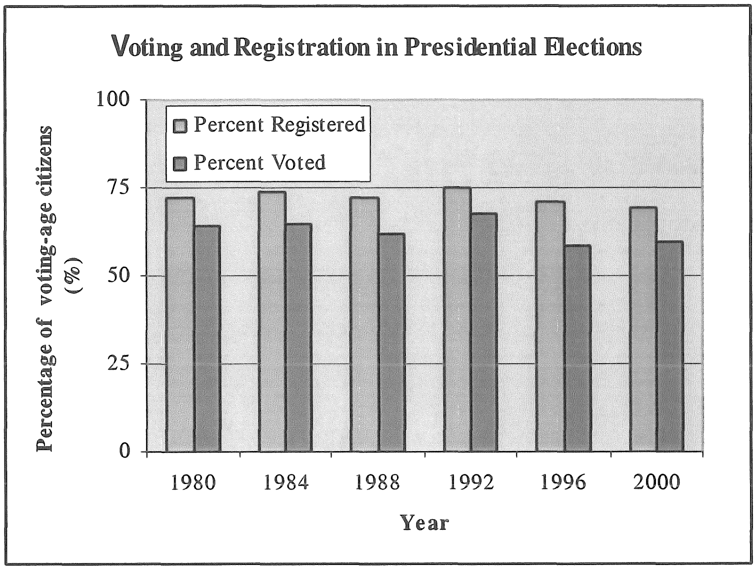
Evidence of Public Apathy in the U.S.

Whereas theoretically public participation is the solution for a number of economic and social problems, including democracy's disembowelment and the market economy's heedlessness of social welfare (Korten 1995; McChesney 1999; Barber 1995), participation remains at levels far lower than necessary to effect the solution. Actualizing this potential among the public means that we do not have to invent any new solution. All that is required is to find an avenue that taps into people's self interest in a way that makes them react.

There is no better proxy for public apathy than voting records. The prospects for socio-economic improvements are the major factors at stake during political elections. Indeed, the selection of political representatives directly impacts the lives of individuals because it determines government policies and actions for a given period of time. Hence, the public has significant incentive for political engagement. Accordingly, the logical expectation points to massive public participation in elections. Nonetheless, voting statistics show a picture sharply contrary to this expectation.

Within the realm of voting, there are two main indicators of public engagement: the percentage of citizens registered to vote and the percentage of citizens that actually vote. The percentage of citizens that actually cast their votes is consistently lower than the percentage of registered voters. In addition, the percentage of voters in congressional elections is more than 15 percent lower than the percentage of citizens that vote in presidential elections. Between 1980 and 2000, on average about 72 percent of US citizens were registered to vote in presidential elections. The percentage of voters was on average 10 percent lower, meaning that less than two-thirds of US citizens actually voted for the president in that period. This causes situations like the controversial elections in 2000 in which less than 30 percent of voting-age citizens voted for the victorious candidate (See Figure 3.1.).

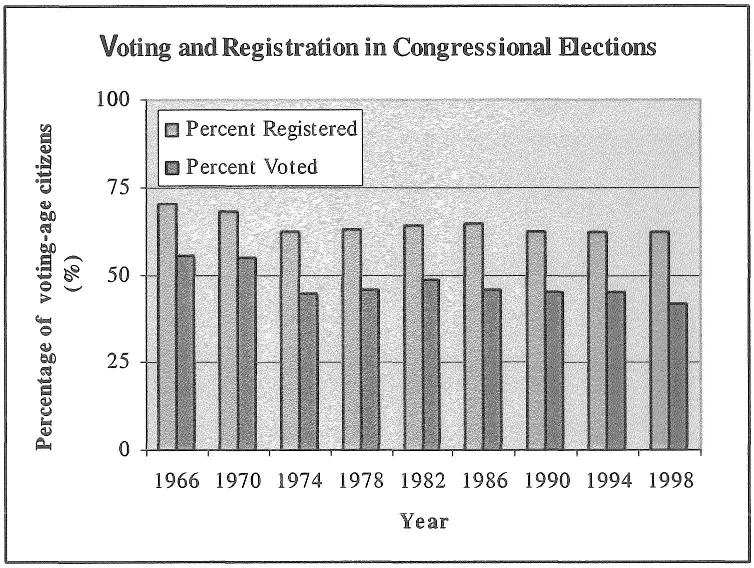
Figure 3.1. Voting and Registration in Presidential Elections



Source: U.S. Census Bureau <http://www.census.gov/prod/2002pubs/p20-542.pdf>

If voting in presidential elections demonstrates a significant level of apathy because about 40 percent of US citizens fail to vote, then voting numbers for congressional elections are even more appalling. Between 1966 and 1998, approximately 47 percent of voting-age citizens voted in congressional elections. During this period, except from 1966 and 1970, less than half of US citizens cast votes in congressional elections (See Figure 3.2.).

Figure 3.2. Voting and Registration in congressional elections



Source: U.S. Census Bureau < http://www.census.gov/prod/2000pubs/p20-523.pdf>

Voting records show that approximately 40 percent of voting-age US citizens did not vote in presidential elections from 1980 to 2000, and about 55 percent of voting-age US citizens did not vote in congressional elections from 1974 to 1998. Moreover, there was a downward trend in voting and registration for presidential elections beginning in 1992, and a similar trend for congressional elections beginning in 1982. This trend led to all-time lows in voting and registration for presidential elections in 2000, when 69.5 percent of voting-age citizens were registered to vote and only 59.5 percent voted. For congressional elections in 1998, 62.1 percent of voting-age citizens were registered to vote and only 41.9 percent voted.[21] Considering that these are federal level elections, and

[21] From the US Census Bureau <http://www.census.gov/prod/2002pubs/p20-542.pdf> ; <http://www.census.gov/prod/2000pubs/p20-523.pdf>

acknowledging the heavy publicity surrounding elections, especially presidential elections, such levels of apathy are remarkable.

If we make a parallel between political involvement and corporate oversight, we would expect less participation in corporate governance among the public in comparison to public participation at the polls. First, the stakes in political elections are clearer because people understand the ramifications of electing a president for four years. They understand less the consequences of corporate financial activities and thereby, the impact of those activities on their lives. Second, the media tends to focus more attention on federal elections than corporate malfeasance, which again encourages greater political involvement in comparison to participation in corporate governance.

Low voting levels may result from either weak incentives or simply from the public perception that voting does not matter at the individual level. Accordingly, people may feel that their votes will not influence the outcome of the election or that the available options will not generate substantially different outcomes. Likewise, public apathy in relation to corporate governance may result from the public perceiving that their involvement is meaningless.

If there were strong reasons for voting yet the public failed to go to the polls, this would suggest significant factors preventing that from happening. Analogously, if the public remains apathetic despite strong reasons for policing corporate life, there might be compelling reasons preventing the expected levels of engagement. This disconnection between economic incentive and public participation may imply an avenue for reconciling corporate activity and social welfare.

4. Public Participation and Social Welfare

Although presently limited, public participation is in theory more viable than a moral transformation and more effective than government regulation in creating social welfare. Accordingly, if it materializes its potential it would be central in bridging the gap between private and public interests.

Public participation in holding government and businesses responsible and accountable to the public good outweighs any alternative because no one but the public has as a primary interest in defending the public's interest. As previously argued, self-interest and greed are quintessential characteristics of capitalist societies; hence, little can be expected in terms of an inclusive moral transformation that would cause the collective to override the self. Analogously, government regulation and oversight will not guarantee social welfare because greed oftentimes brings government and businesses together and in conflict with the public good. Thus, it depends on the public as to whether finance capitalism can be reconciled with *de facto* democracy.

Although public participation is the key to democratizing contemporary social systems, it is virtually absent in the U.S. in terms of the scale needed to promote the required changes. Thus, to bridge the gap between private and public interests it is necessary to understand the foundations of public apathy. The explanation underlying public apathy implies the solutions for disconnections between shareholders and managers and corporations and social welfare. Therefore, mitigating the determinants of public apathy can also solve the agency problem and the conflict between society and corporations that corrupt finance capitalism.

Society is dynamic and heterogeneous; thus, there is a need to address several complementary reasons for the lack of public participation. For instance, it is necessary to assess the motivation of people to participate, their ability to participate, and the factors that inhibit or constrain public participation in general. To this end, in the following section, I examine four determinants that may explain the lack of public participation in contemporary societies; in particular, the United States. Although I have identified four major explanatory variables, I do not claim that these are all-inclusive. However, they help to provide a better understanding of the failure of public outrage following the Enron and WorldCom debacles.

4.1. The Free-Rider Problem:

The free-rider problem refers to one's differential gains from acting as opposed to remaining passive. It is framed as a problem because oftentimes people's judgment tends to lead individuals to accommodate to the status quo. That is so because in general individuals tend to perceive that their participation will not change outcomes as to result in significant gains for themselves. Consequently, instead of participating, individuals resign to riding with the flow. In sum, whenever individuals consider that their participation will not bring results for the group that incur significant gains for themselves, they will not participate.

Within the general framework of the free-rider problem, there are three interrelated realms: (1) the individual's perceived ability to influence outcomes; (2) the perceived costs of participating; and (3) the perceived burdens inherent to not participating. The ability to generate significant differential gains by participating refers to one's self-evaluation in relation to the economic and political powers of pertinent actors and institutions. It may also be understood as individual's assessment of whether or not their participation matters. Within this context, the free-rider problem has a negative impact when share-ownership is dispersed among many shareholders in a way that each shareholder is powerless to influence corporate behavior alone. The same rationale applies to the relationship between civil society and corporations because of the massive gap between the economic and political power of the ordinary citizen and that amassed by corporations which makes individuals feel powerless, thus discouraging participation. Comparatively, because power is much less concentrated within society at large than within the circle of shareholders of a corporation, and civil society's interest is much less clearly connected to corporations, the free-rider effect is predictably stronger within society. This implies a larger disconnection between civil society and corporations than between shareholders and managers of corporations. Yet, this is only a matter of scale for a problem that is ubiquitous.

The asymmetry in the distribution of power within civil society implies that those that have command over the political economy have more incentive for political and economic participation, while those that are less influential feel disconnected or insignificantly related to it. In other words, "[t]o the extent that participation and apathy depend upon the sense of significant membership in the society, social stratification systems function to distribute the motivations to participate unequally" (Tumin 1998: 108). Hence, diverse socioeconomic situations translate into different incentives for participation. The less connected to the spheres of political and economic decisions individuals feel, the less influential individuals are likely to feel. In line with the conceptualization of social stratification as a result of the unequal distribution of power (Weber 1978; Tumin 1998), those individuals with lower economic and social status and political clout will be the least influential, and thereby the least motivated to be active political and economic participants. Consequently, social stratification feeds a self-reinforcing cycle that alienates civil society from the political economy, contributing to low voting percentages relative to the total voting-age citizenry and little or no involvement in corporate life. An analysis of voting records in the last two presidential elections corroborates this rationale, showing a clear inverse relationship between income and voting (See Figures 4.1. and 4.2.).

Figure 4.1. Reported Registration for Presidential Elections (U.S. Census Bureau)

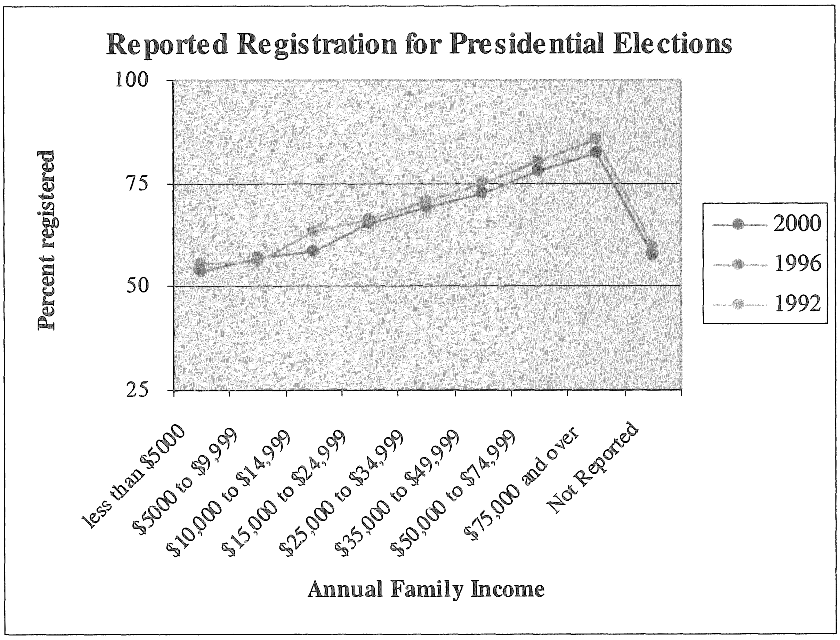
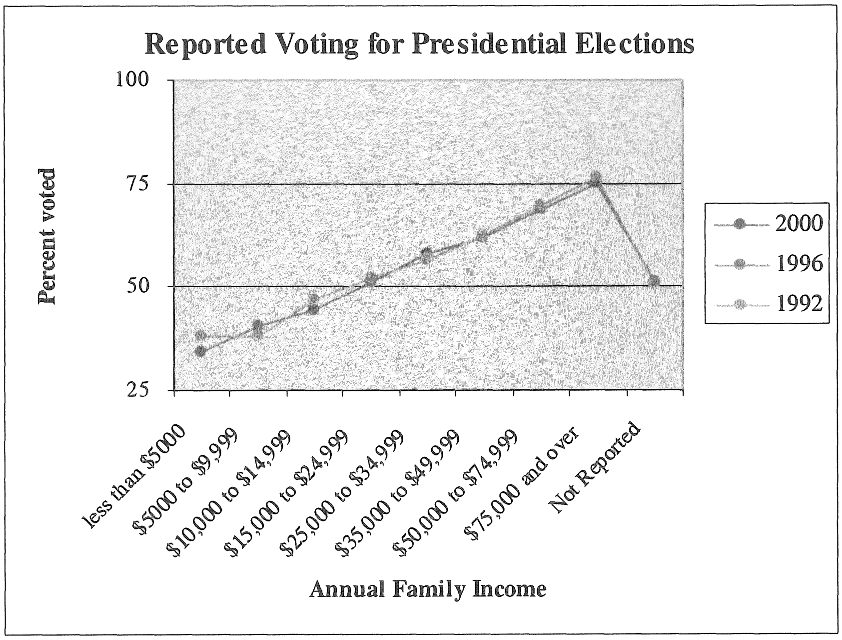


Figure 4.2. Reported Voting for Presidential Elections (U.S. Census Bureau)



Another constitutive factor of the free-rider problem is the cost of participation. The costs of participating or acquiring information and the ability to participate influence the levels of participation as they are weighted against the prospective benefits of participation. Whenever individuals judge that participation does not pay off, or that their informed participation does not offset the costs of getting informed to participate, they will choose to remain apathetic or rationally ignorant about the actual stakes of decisions and actions in society's economic and political realms. In other words, individuals prefer remaining passive or only superficially informed when the related costs surpass the prospective individual benefits.

A central determinant of political apathy is that most individuals tend to overlook the scope of political participation, usually relating it to voting only. Consequently, individuals feel powerless because a single vote is perceived to be insignificant. This is a result of an understanding that a vote will have only a 1/T power over elections, where T is the total voting-age citizenry. Thus, individuals perceive that the costs of researching the policy platforms of the candidates and casting an educated vote tend to swamp the impacts of one's vote. Analogously, because individuals tend to perceive themselves as powerless in relation to the major corporations, the perceived costs of learning about business operations and their impact on society, as well as of acting to amend the identified negative impacts, tend to be considered much greater than the prospective benefits.

Finally, individuals do not have an incentive to participate whenever the perceived burden of not participating is deemed insignificant on an individual basis. That is, individuals tend to lack motivation to participate when they are not significantly burdened by policies and actions. Irrespective of the scope of government or corporate actions, individuals usually conceptualize a burden of only B/P inherent to government policy and action, where B is the total burden and P is the total population affected. Thus, the negative impacts of government and corporate actions are cognitively dispersed in a way that the perceived impacts on each individual tend to be limited, thus failing to generate the motivation to participate.

The free-rider problem explains the lack of public participation as being the result of insignificant differential benefits or losses incurred by participating or not. The rationale underlining the free-rider problem involves different levels of incentives across individuals. The quintessential premise of the free-rider problem is that an individual acts based on specific incentives relative to himself or herself rather than the collectivity. This conflict between the self and the collective has implications for the levels of public participation and consequently for the levels of attainment of the social good.

The predominance of the self over the collective in public life affects the levels of public participation because of the divisional impact that results from the distribution of the stakes proportional to a single person. That is, because individuals pursue their own interests, their parameter to assess reality is the self rather than the collective, wherein individuals usually assess the direct implications of policies and actions to them alone rather than to the entire community involved. By doing so, individuals underestimate their power to influence society and the inherent burdens of not participating.

Within the framework of the free-rider problem, self-interest leads individuals to perceive that their voting power is 1/T rather than T (T = total voting age citizenry), and that the burden of government or corporate actions is B/P rather than B (B = total burden and P = total population affected). Public power is underestimated by T(T-1), and the negative impacts of government and corporate actions are underestimated by B (P-1)/P.

The consequences are that individuals have a sense of insignificance equal to 1/T-1, which refers to one's power relative to the combined power of all other social actors, and that B (P-1)/P is overlooked, wherein B fails to generate enough incentive for individuals to participate.

The Public and Corporate Life

The straightforward assessment of an individual's ability to influence socio-economic policy as 1/T within the scope of democratic elections is not as clear in terms of the interaction between civil society and corporations. For instance, individuals who do not own stocks or other corporate asset have no clear instrument by which they can influence corporate behavior or exercise control over corporations. This lack of control leaves the public with no direct means of corporate influence and also prevents participation because the public has no economic stake clearly connected to corporate behavior.

The difficulty for an ordinary citizen to determine the burdens of corporate activity to himself or herself reduces the motivation or incentive to participate in corporate life. The loose connection between the impacts of corporate activity and one's life makes the perceived burdens tend to zero, because either the impacts tend to be overlooked or they are perceived to dissolve within an indeterminate universe:

$\mathrm{Lim}_{P\,0>\infty}$ B/P = 0; where B = total burden and P = total population affected

In addition, individuals fail to recognize the ways they might influence corporate behavior. Moreover, the power of civil society to influence corporations is perceived to be loosely distributed among a large indeterminate universe:

$\text{Lim}_{T\,0>\infty}\ 1/T = 0$; where T = total population affected by a corporation's activities

When the perceived burdens of corporate activity tend to be null, and the individuals' perceived power to influence corporate behavior also tends to be null, individuals have neither a specific incentive to participate nor positive prospects relative to their participation. Hence, individuals usually lack motivation to participate irrespective of the conspicuous signs of relative deprivation because their assessment of corporate life as self-centered rational actors dissolves incentives and demotes the prospective differential outcomes.

Shareholders and Corporate Life

The formalized argument used to explain public apathy fails to completely explain shareholder apathy. Contrary to the relationship between civil society and corporations, within the framework of the agency problem the number of individuals related to a corporation by share-ownership is determinate. Thus, the stakes to each shareholder can be generically represented as:

$\mathrm{Lim}_{P\,0>z}\, B/P = B/Z$; where Z = share-ownership factor = N/n

N = total number of minimal units of ownership (individual shares or blocs of shares)

n = number of minimal units of ownership owned (individual shares or blocs of shares)

Analogously, a shareholder's power to influence a corporation is also not null:

$\mathrm{Lim}_{T\,0>z}\, 1/T = 1/Z = n/N$, where $Z > 0$

In cases in which share-ownership is fairly dispersed, Z becomes significantly large and the framework of shareholder participation parallels that of civil society. Since this is not always the case, there might be other determinants keeping shareholders from closely policing corporate activity. Nonetheless, other determinants expectedly combine with the fact that in the absence of sufficient incentives most individuals are likely to remain apathetic, resigned to conducting their lives without engaging in attempts to challenge the status quo and transforming the economic and political systems. Since public resignation permits the continuation of the prevailing power relations, the free-rider problem has a negative inertial effect on the attainment of the social good.

4.2. Contentment and Conformism

Besides the free-rider problem, there are also several perverse incentives that work to prevent public participation. These perverse incentives, which encourage conformity to the status quo, entail a combination of psychological factors and deliberate measures that take advantage of an uninformed public. Both those to whom the political economic system caters and those who are underprivileged in the current system are subject to such incentives.

The most compelling disincentive in challenging the status quo follows from the preservation of one's perceived well-being. A general contentment with life tends to reduce the need to engage in activity that aims to change the political economic system and encourages activity that preserves it. That is, it is logical for individuals acting in their own self-interest who are satisfied with the status quo to attempt to preserve their current living conditions. Indeed, preserving one's well-being is a natural impulse, and in general, all but those who are altruists pursue their well-being before that of others. Whereas there are altruists within finance capitalism, altruism is certainly not the general rule. Accordingly, the combination of individualism and contentment favors efforts towards the preservation of the status quo by those who it privileges, irrespective of the detrimental consequences to those who are underprivileged.

Contentment locks in the political economy by encouraging support for the preservation of the status quo among those who benefit from good living conditions. That is, if individuals are content, there is no reason to challenge the status quo. We would expect that the higher the social and economic status and political clout of an individual, the greater that individual's contentment with the status quo. Logically, it follows that the greater the satisfaction with the status quo, the greater the incentives for preserving it. Thus, it is unsurprising that voting rates increase as previously demonstrated on Figures 4.1. and 4.2. because those in the upper economic tiers have interest in going to the ballots to make sure their positions are preserved. Indeed, "[contentment] operates under the compelling cover of democracy, albeit a democracy not of all citizens but of those who, in defense of their social and economic advantage, actually go to the polls. The result is government that is accommodated not to reality or common need but to the beliefs of the contented…"(Galbraith 1992: 10).

Besides self-interest, a prevailing concern among those who are currently benefiting from the status quo is with well-being in the short-run. That is, measures that provide short-term benefits are preferred to measures with long-term benefits for two reasons. First, future outcomes are considered reasonably indeterminate. That is, future gains cannot be predicted with certainty. Second, long-term benefits might benefit others and thereby, reduce any individual gains. Moreover, individuals usually find it preferable to secure short-term personal gains than to pursue measures providing collective benefits in the short-run and prospective personal gains in the long run.

Individualism and short-term mindset ("immediatism") produce conformity, which helps to perpetuate the status quo. However, conformism is not necessarily dependent upon contentment. That is, conformity to the status quo is not class dependent. Indeed, all social classes – privileged and underprivileged – are governed by a set of perverse incentives that induces social conformity and even compensate for the lack of contentment among the underprivileged. In addition, there are incentives that promote contentment that are perversely independent of actual socio-economic well-being.

Conformism and the Contented

It is reasonable that only those in the top quintile of economic status really have reasons to be satisfied with the status quo and thus prefer that it remain unchanged. The lower quintile, among which more than half are living under the poverty line, certainly have no reasons for contentment. The middle social strata entails varying degrees of satisfaction given the spectrum of socioeconomic status it hosts, but overall it tends to show more contentment and conformance than befitting its actual situation. Thus, within the milieu of the contented, the middle-class is of most interest.

In terms of contentment, comparative well-being exercises great influence over the middle-class. Indeed, "people can increase their well-being through comparison with a less fortunate other" (Hogan 2001: 49). Thus, the existence of an underclass helps to promote satisfaction about the living conditions of the middle strata. Accordingly, the higher an individual is positioned on the social ladder, the greater his/her comparative well-being and thus the greater the contentment with his/her living conditions. Thus, the perception of well-being is not necessarily understood in absolute terms. Instead, most individuals in the middle-class compare their well-being to those that are situated lower in the stratification system. Moreover, because of their fear of losing this relative well-being, the middle strata has an incentive to accept and support the status quo. Thus, the middle-class conforms to the political economic system "in return for protection for itself"(Galbraith 1992: 27).

Status comparison renders great fuel for consumerism, which in turn fosters conformity to the socioeconomic structure for establishing the parameters of comparative status within the boundaries of the existing political economy. That is, because within finance capitalism greater and more valuable – or prestigious – stocks of material goods attribute higher status, the pursuit of socioeconomic status induces conformity to the capitalist structure. In fact, "[social pressure] is never a pressure to change the social structure – even if such change would benefit the group in question. Rather, it is always a pressure to conform, to proceed in the normal way…" (Hogan 2001: 30). Consequently, the universe of options individuals usually conceptualize for any particular case is likely to be limited to a set of possibilities within the boundaries of the established social structure. Consequently, dissent is undermined before its very consideration since the social environment conditions people to think and behave in line with socially established norms.

The pressure to conform includes the disapproval of dissident behavior, which is usually condemned in a way that dissidents become seen as pariahs or unfortunate aberrations. Accordingly, the fear of being an outcast curtails dissent (Hogan 2001). That is, the desire to conform – or the fear of non-conformity – makes most people follow the socially accepted norms and avoid deviant behavior that would deny membership in the social environment. This is true in every sphere; both the personal and the professional environments are subject to this pressure for conformance. Professionally, individuals develop expertise about their workplace and the network that is necessary to operate in the system, thereby becoming interested in its continuity because substantial changes would undermine such assets. Besides, mainstream institutions such as the broadcast media and the print media also can boycott or downplay dissident behavior in a way that such behavior might hurt the livelihoods of dissidents (Hogan 2001).

The influence of the commanding institutions – or the domains of the holders of economic power – over the social environment is also critical in shaping the ideological framework that supports the status quo. These institutions have the ability to manipulate reality to fit the ideological framework. That is, an ideology "foster[s] in people the sense that the current system is right, that it is beneficial, that alternatives are threatening..."(Hogan 2001: 59). In short, an ideology justifies the existing system and serves to garner support even among those that are less or not favored by the system. Finance capitalism and its neoliberal ideology provide support for the unrestrained pursuit of individual wealth and the limited responsibility of the state to society in terms of the failure to challenge the current distributional disparities in income and wealth (Galbraith 1992). More specifically, the neoliberal doctrine cultivates the popular belief in the trickle down effect, whereby high corporate earnings are associated with good economic performance and the creation of new jobs. This is in fact a mystification of reality because high earnings are oftentimes not related to productive activity. This and several other twists of the neoliberal interpretation of reality serve to support the status quo and overshadow the internal inconsistencies of the current economic system.

Conformism and the Underprivileged

There is no doubt that much of what is valid for the group of contented does not apply, or only partially applies, to those that are in the lower socioeconomic strata. For the latter group there are other factors that are more critical in promoting conformism to a social structure that is detrimental to their well-being.

Perhaps the most straightforward motivation for conformance, or lack of dissident participation, is the contingency of their socioeconomic situation. That is, they lack the ability to devote time and effort in attempting to change the system. Consequently, it is easier to conformism. In addition to that, there are two other factors that are critical: coercion and structural ignorance. Coercion materializes especially in higher rates of arrests and convictions for blacks, who constitute the bulk of the underprivileged (Hogan 2001). In line with that, as a result of ignorance about the law and its procedures, as well as the lack of means to be actually protected by the law, individuals avoid taking the chance of becoming subject to the actions of law enforcement agencies by engaging in dissident activities.

Another factor contributing to conformance to the status quo among the underprivileged is the social fragmentation generated by the stratified system. Stratification conveys the notion of the possibility of social mobility at the same time that it makes "everyone into competitors for advancement and threats to one another's security" (Hogan 2001: 46). Consequently, the system undermines the only way that could help the underprivileged transcend their economic contingency to attempt to change the system in a way that they are provided more equitable opportunities.

The Media and the Hidden Dissent

Whereas the core neoliberal ideology provides a framework for the justification of the socio-economic structure, it needs continuous institutional reinforcement. The education system plays a significant role in promoting social conformance since the political economy is usually taught as the norm and dissident behavior is normally treated as an inconsistency or an aberration. Another way of fostering conformism is to frame social issues in ways that induce allegiance to the reigning ideology (Hogan 2001). The use of the media by the government and corporations is instrumental in framing social issues presented to the public in ways that are favorable to the preservation of the status quo rather than giving individuals the chance to frame them by themselves. Moreover, the media is a chief asset of those individuals and institutions to whom the system caters because it has the power to manipulate public attention. That is, the media has the ability to direct attention to topics of interest of the government and corporations and preempt attention to those topics that they prefer to leave uncovered. A clear example of that is the focus on reporting the share of the government budget allocated to social welfare while neglecting to report the much higher numbers involved in corporate welfare (Olson and Champlin 1998). This control is possible because of corporate ownership of or indirect power over (on the grounds of paid-adds upon which the media depends) media channels (McChesney 1999; Herman and Chomsky 1988). Besides, the media relies on the government and corporations as sources of information, clearly dismissing any need for direct censorship beyond that self-censorship exercised by the media based on its dependency patterns (Hogan 2001: Herman and Chomsky 1988).

The media also serves the purpose of blocking the contented from identifying with the underprivileged (Hogan 2001). That is, the media helps the contented to accept the political economic system by portraying the underprivileged as a distinct group in a way that the contented do not feel responsible for the destitute conditions of others. Thus, the contented do not feel guilty for enjoying their contentment and not engaging in helping the underprivileged. This helps conformance because it avoids that individuals think that the system imposes burdens to certain groups of people so that other groups can enjoy good living conditions. Disparities of stratification thus become acceptable and even normal, consequently preventing any confrontation with the commanding ideology.

4.3. Knowledge

A central requirement for effective public participation in overseeing corporate activity is certainly an understanding of business operations and financial reports, which imply knowledge of economics, politics, finance and accounting. The lack of such knowledge impairs one's ability to oversee corporate activity and participate in corporate governance. Hence, without the necessary knowledge, individuals are incapable of influencing corporate activity to promote socially beneficial outcomes or at least to prevent heavy economic burdens inherent to corporate debacles such as those of Enron and WorldCom.

The level of knowledge of the corporate world differs across social constituencies. Among other factors, income and schooling differentials determine different levels of understanding of finance, accounting, economics, politics and corporate operations. A distinction between shareholders and the general public captures, in general terms, the differences in levels of understanding of corporate activities as well as the distinction between the agency problem and the disconnection between society as a whole and corporations. Thus, in what follows I assess separately the extent of the general public's and of shareholder's knowledge of the corporate world.

The Public's Knowledge of the Corporate World

For the purposes of this study, the general public is defined as that parcel of the population that does not own stocks or any other asset of corporations. Individuals who own stocks through pension funds are also considered constituents of the general public because stock holdings through pension funds or other institutions of the like do not entitle individuals to control their holdings. In those cases, administrators rather than the individuals themselves oversee stock holdings. According to this definition, the general public is a very heterogeneous group, wherein there will always be members that will not fit the general definition of the group. Nonetheless, this is a generalization, and what matters is that this definition captures the characteristics of the majority.

According to the New York Stock Exchange, 84 million individuals owned stocks directly, through mutual funds, retirement saving accounts or defined contribution pension plans in the U.S. in 1998.[22] Among those, 33.8 million individuals owned stocks directly only.[23] Thus, for the purposes of this study I consider that there are 33.8 million shareholders in the U.S.; the remainder of the population, including those who own stocks indirectly, are considered constituents of the general public. To obtain the percentage of shareholders as compared to the percentage of the general public, I considered only individuals 18 and over. Accordingly, as of 1998, 16.6 percent of the population were shareholders.[24] That is, 83.4 percent of the population are considered the "general public" for purposes of my analysis (See Table 4.3.1.).

To assess the general public's understanding of the corporate world I used "specific training" as a proxy. In this perspective, I consider a Bachelor's degree in one of the areas of expertise needed to oversee corporate activity as a minimum requirement. The data indicates extensive public ignorance of the corporate world. To begin, as of 2003 only 27.2 percent of the U.S. population had a Bachelor's degree or a higher degree

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22 The Investing Public <http://www.nyse.com/pdfs/05_INVESTINGPUBLIC.pdf>
23 The Investing Public <http://www.nyse.com/pdfs/05_INVESTINGPUBLIC.pdf>
24 Calculated in accordance to the approximate population 18 and over in 1998. Source: U.S. Census Bureau, Census 2000 Summary File 1.

in any area of study.[25] This picture limits significantly the universe of individuals who might have at least basic notions of economics, finance, accounting, business management, politics or sociology at a level such that allows at least superficial critical assessments of corporate activity and of the political economic system in general. Among those who have at least a Bachelor's degree, only a third graduate with a business or social science major.[26] This means that only about 9 percent of the U.S. population have the necessary training to understand corporations and their activities. Thus, assuming that such proportion applies equably across social groups, 91 percent of the general public, representing about 76 percent of the entire adult population, lack the necessary knowledge to oversee corporate activities (See Table 4.3.1. below). This means that the majority of the general public is incapable of participating in corporate governance, a reality that weakens the public power over the economy and favors corporations by allowing their activities to go unbridled.

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[25] From the U.S. Census Bureau report: *Educational Attainment in the United States: 2003* <http://www.census.gov/prod/2004pubs/p20-550.pdf >

[26] From the U.S. Census Bureau <http://www.census.gov/population/socdemo/p70-72/tab05a.txt>; This data refers to 1996, the most recent available. The data compiles the many majors under broadly-defined fields of training, among which *business* and *social science* include but are not limited to those majors that would provide reasonable knowledge of the corporate world. Besides, a Bachelor's degree in any field of training related to corporations does not necessarily guarantee either inclusive knowledge or a critical perspective of the political economic system. Hence, the proxy adopted overestimates the ability of individuals to oversee corporate activity.

Table 4.3.1. Shareholders and the General Public in the U.S.

		% of the population	Knowledge
Shareholders	16.6%	1.5%	Yes
		15.1%	No
General Public	83.4%	7.5%	Yes
		75.9%	No
Total	100%	100.00%	

For the most part the economic situation of individuals keeps the general public from owning stocks and being part of the corporate world. Yet, ignorance about corporate operations also prevents individuals from participating in the stock market and in corporate oversight because ignorance eases the mystification of the political economy (Hogan 2001). That is, the lack of the necessary knowledge to understand and participate in corporate governance helps explaining why 91 percent of the general public perceive that corporations and their activities entail a level of complexity beyond their grasp. Such perceived complexity discourages participation and more importantly, the learning to enable participation. Thus, ignorance and apathy reinforce each other and keep the majority of the general public without the knowledge required to corporate activity.

Shareholders' Knowledge of the Corporate World

For purposes of this study, shareholders are characterized as having direct stock-ownership. Only those who exercise control over their stockholdings should be considered to belong to the group of shareholders. According to Table 4.3.1., shareholders constitute approximately 16.6 percent of the U.S. population. Among them, about 9 percent, or 1.5 percent of the total adult population, have the necessary knowledge to oversee corporations, whereas the majority, constituting 15.1 percent of the total adult population, lack the ability to participate in corporate governance.

Compared to the general public, shareholders have a greater incentive to have at least a superficial understanding of the corporate world. Their stock ownership provides an added incentive to follow the general news about the corporations in which they own stocks as well as the major trends in the stock market and in the economy in general. Nonetheless, this does not always provide individuals with the ability to completely understand the implications of corporate activity, nor can we assume that individuals outside the company have perfect information. As previously discussed, there is evidence that most shareholders lack such ability and information. For analytical purposes, I divided shareholders in those that follow stock prices without specific knowledge of accounting, finance and industrial operations, and those that actually understand the political economic system and financial and accounting mechanisms of firms.

A considerable number of shareholders are individuals who were dragged into the stock market by the appeal of quick enrichment. Another possibility is that, if nothing else, they were driven by emulation or the desire not to fall behind on status comparison by staying out of what apparently proves to benefit many. The majority tend to have only a superficial knowledge of the stock market and the corporate world itself, oftentimes delegating the administration of their stock holdings to brokers or merely following identifiable patterns. Therefore, their participation in the stock market does not imply the ability to exercise effective corporate oversight.

On the other hand, there are shareholders who have the necessary knowledge to oversee the activities of corporations and consequently are able to ensure that corporate activity is not socially harmful. Nonetheless, these shareholders who have the ability to effectively oversee corporate behavior on behalf of the social good in reality fail to do it because either it conflicts with their immediate interests or they have imperfect information. Thus, knowledge alone does not prevent individuals from exercising the role their capability allows them to perform.

4.4. The Pecuniary Mindset

One explanation for the failure of individuals who have the ability and required information to oversee corporate activity and promote social welfare to do that is that it is simply not in their interest to do so. Within financial capitalism, the central goal of stockholders is pecuniary gains rather than investing in socially responsible operations. Since pecuniary gains are likely to accrue faster and in many cases exceed the gains from productive activity, the stockholder has an incentive to favor pecuniary activity over productive and socially responsible activity (Veblen 1904; Cornehls 2004).

The pecuniary mindset is conditioned to pursue pecuniary gains irrespective of the means through which such gains are accrued (Veblen 1904). Accordingly, "…stockholders in the aggregate do not seem to care whether the corporations in which they invest have good or bad reputations. They are interested in the value of their stock, principally in its rapid appreciation" (Cornehls 2004: 45). This behavior is systemically nurtured in a way that it is continuously self-reinforcing. Stocks are consistently ranked based on financial rather than social performance; hence, individuals become conditioned to evaluating them in relation to their pecuniary gains and fail to assess the impact of the activities of corporations on social welfare.

Popular business periodicals are central in perpetuating the pecuniary mindset. In an article entitled *The 2004 Fortune All-Star Portfolio*, Fortune magazine underscored ten stocks deliberately selected by the so-called "all-star analysts." All the reasons informing the analysts' selection were related to the prospective pecuniary gains; there was no mention whatsoever of the social outcomes of the activities of the corporations whose stocks were recommended.[27] *BusinessWeek 2004 Investment Guide* issue denotes as key parameters to identify top-notch stocks: sustainable earnings growth; a dominant position in the industry; a strong balance sheet; abundant cash flow; and ability to pay dividends.[28] Again, there is no mention of gains in social welfare, and ironically, the article that carries this list is entitled *The Quest for Quality*. This suggests that quality refers to pecuniary rather than social parameters. In *BusinessWeek* 2004 performance ranking of the Standard & Poor's 500, the parameters to measure the performance of corporations included total return, sales growth, and profit growth at one and three years intervals, net margin and return on equity.[29] Additionally, in the issue addressing the 100 best performing corporations in information technology, the parameters highlighted were revenues, revenue growth, return on equity, shareholder return, and profits.[30] When the analysis focuses on countries, it is not different. In *The Economist*'s "The World in 2004," countries are represented by GDP growth, GDP levels, the inflation rate, population, and GDP per head; not by their index of human development (IDH), the improvement in the IDH, the decline in income and wealth inequality or efforts to curtail environmental degradation.[31]

Likewise, electronic domains also contribute to and perpetuate the focus on pecuniary gains. For instance, internet engines that offer guidelines for managing stocks invariably recommend weighting growth trends, the history of the growth of stocks, and the financial soundness of the company (see Table 4.4.1. below).

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[27] "The 2004 Fortune All-Star Portfolio," *Fortune* (June 14, 2004), pp.152-172
[28] "The Quest for Quality," *BusinessWeek* (June 28, 2004), pp. 112-116
[29] "Performance Ranking S&P 500," *BusinessWeek* (April 5, 2004), pp. 127-150
[30] "The Information Technology 100,"*BusinessWeek* (June 21, 2004), pp. 94-101
[31] "The World in Figures: Countries," The Economist (The World in 2004), pp. 85-91

Table 4.4.1. Parameters Recommended to Inform the Selection of Stocks by some Internet Sites			
Internet Sites	Focus		Recommendations
	Financial	Social	
Amateur-Investors.com	✓	-	Follow stock price patterns
BigTrends.com	✓	-	Follow market trends
Kiplinger.com	✓	-	Return on equity; free cash flow; price-to-earnings ration; price-to-book ratio
The Rookie Day Trader	✓	-	Follow financial news; check the financial basis of stocks; SEC filings; compare with DOW and NASDAQ
MSN Money	✓	-	Check Company Report for growing potential; SEC filings; profits margins; price-to-earnings ratio; earnings estimates

Among the sample presented in Table 4.4.1., only MSN Money recommended a close look at the SEC's 10-K Management Discussion section for information about how the business operates. All others focused solely on financial parameters such as market trends and earnings ratios. Most notably, none of them – including MSN Money –

mentioned that the investor should have any concern about the impact of corporate operations on society. There was no advice whatsoever to verifying the implications of the operations of corporations with attention to the negative externalities that result from corporate operations. This only reinforces the pecuniary mindset because newcomers tend to follow the conventional guidelines that underpin the existing political economy.

In their role of diffusing the pecuniary mindset, electronic domains echo the mantra endemic to finance capitalism. The many channels of diffusion of finance capitalism reinforce each other, but they indelibly emulate the central institutions within the system. As a core institution within global finance capitalism, The New York Stock Exchange (NYSE) plays a significant role in shaping the pecuniary mindset. Accordingly, the NYSE website has a section on education that offers a guide to the NYSE in which it delineates that a company's financial health, the industry's performance, major economic trends, and world and national events are the driving forces behind the movement of stock prices.[32] There is no mention of the impact of corporate activity and financial markets on society at all; the parameters guiding stock prices are presented as purely financial and economic. Moreover, the NYSE has an education center that sponsors teacher seminars to promote investment education. The 5-day programs are free of charge and are open to teachers, journalists and college students. The NYSE's website even provides a class plan specifically designed for middle school and high school students,[33] a strategic audience for guaranteeing the continuation of the pecuniary mindset because students learn to conform to, but not to question finance capitalism.

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[32] From the NYSE website.
<http://www.nyse.com/about/p1020656067652.html?displayPage=%2Fabout%2F1022221392718.html>
[33] From the NYSE website.< http://www.nyse.com/pdfs/TG_Mech.pdf >

This evidence suggests that the pecuniary mindset is pervasive and self-reinforcing. As long as it continues to prevail in the media, on the internet, in education, and in most realms of capitalist societies, there is little chance that those involved in pecuniary speculation will be the vanguard in preventing the next round of corporate malfeasance and fixing the current economic system.

5. How an Active Civil Society Can Change Corporate Behavior and Promote Social Welfare

In the preceding section, I analyzed four factors that contribute to preventing public participation in corporate oversight and in social governance in general. The impact of these preventive factors on contemporary capitalist economies is to allow unbridled corporate greed by making individuals complacent. The result has been an overall decline in social welfare. In the next section, I will argue that if the barriers to public participation in the economy and in politics are mitigated, we can begin to address the problem of corporate malfeasance in particular and the negative impact of finance capitalism on social welfare in general.

Among progressive scholars there is a virtual consensus that the key to reclaiming society and "…to make[ing] government our own is to recast our civic attitudes, which is possible only in a vibrant civil society where responsibilities and rights are joined together in a seamless web of community self-government" (Barber 1995: 276). That is, "[w]e must transform the system itself by reclaiming the power that we have yielded to the corrupted institutions and taking back responsibility for our own lives"(Korten 1995: 294). In other words, by actively participating in a society's economic and political governance, individuals exercise their power to influence such realms. The consequence of exercising the rights of citizens rather than withdrawing from exercising such rights can be exponential. Public participation is beneficial to society because it has the potential to ensure that the economy and the polity work for the public interest. In addition, by participating individuals do not give up their power as citizens to influence society to either corporations or the government. As long as corporations perceive the public as apathetic, they will also perceive themselves to be more powerful than society. But if the public is engaged with political and social issues, and willing to challenge bad corporate behavior, corporations will have a greater incentive to change their inappropriate behavior.

In a system in which there is extensive public participation, individuals conceptualize his/her ability to influence social outcomes as a constitutive part of the collective power rather than as an independent capability that is overwhelmed by the pervasive power of corporations. Hence, instead of conceptualizing that individual power dissolves among a largely indeterminate universe of unrelated units, individuals perceive their power as growing as it is increasingly less dissipated. Following the formulation advanced in section 4.1., T (perception of disunity related to the total population affected by a corporation's activities) will tend to zero because individuals will perceive that individual action leads to collective power - a power that grows as the number of individuals involved grows. Thus,

$$\mathrm{Lim}_{T \infty > 0}\, 1/T = \infty$$

The consequence is that individuals will feel empowered in relation to corporations, the government, or any institution that might negatively affect their well-being.

Analogously, when individuals conceptualize the impact of corporate activity on them personally, they will assess their personal burden through a collective lens:

$\mathrm{Lim}_{P\,\infty > 0}\ B/P = \infty$; where P = perception of disconnection among the population affected

An additional outcome of this shift from individual to collective conceptualization of public power is that to the extent that corporations acknowledge this power, it automatically puts pressure on them, because they recognize the power behind the "public will" to contest their behavior. Consequently, corporations would have a greater incentive to refrain from acting in ways that would knowingly cause public outrage or reaction. The way this public pressure materializes its potential to improve social systems and to enhance social welfare is through social and political activism.

A society in which most individuals actively participate in shaping the social, economic and political order is the key to promoting social welfare because it impedes those private privileges that degrade social welfare. In my view, there are two avenues through which public action or true citizenship can curtail corporate malfeasance and work to change finance capitalism for the improvement of social welfare. These are 1) behavioral activism and 2) attitudinal activism.

By behavioral activism I mean individual citizens making choices as consumers, voters, or community members that punish corporate malfeasance or any institution of the political economic system that harms social welfare. This includes individual actions that promote the boycotting of products of corporations that use child or quasi-slave labor, expose employees to insalubrious working conditions, generate negative externalities such as water, air and soil pollution in production processes, offer products that are knowingly unhealthy, and so forth. Citizen action also means going to the polls and voting out-of-office politicians that support, or fail to react positively, to corporate malfeasance and other losses in social welfare. Furthermore, citizen participation means avoiding social events and functions at private and public facilities sponsored by corporate malefactors. These are ways to influence corporate behavior through simple individual choices on a daily basis. In other words, daily actions do not necessarily mean that individuals have to devote lots of time or substantial funds to achieve their aims. In order to influence the economic, political, and social behavior, it is only a matter of making purposeful choices in our normal daily activities. This includes, for instance, trading gas-guzzler SUVs for more gas-efficient cars such as sedans with smaller engines or hybrids, an action that has gained momentum with the recent rise in gas prices.[34] Yet, before the pricey-gas factor individuals were already showing greater interest in hybrids, regardless that this constituted a non-rational choice because hybrids usually cost from $2,000 to $3,000 more than comparable vehicles. Despite such price differences, the Toyota Prius and the Honda Civic hybrid, now more than ever, are hot items at their respective dealerships.[35]

The second action by which the public can constrain illicit corporate behavior is through "attitudinal activism." By attitudinal activism I mean what is normally understood as public activism: that is, the organization of collective fronts to discuss and pursue within the polity the enactment of policies and regulations that meet the public interest, and to advocate for corporate practices that prevent labor exploitation,

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[34] "Steering Away from Guzzlers," *BusinessWeek* (May 31, 2004), pp.28-30
[35] "Steering Away from Guzzlers," *BusinessWeek* (May 31, 2004), pp.28-30

environmental degradation, and any sort of negative externality directly related to corporations. This includes unions, community organizations, professional organizations, or any sort of social organization within civil society. Through these organizations, individuals collaborate in an effort to curtail illicit corporate behavior than harms social welfare and to take pro-active steps to transform the political economic system.

One example of attitudinal activism is the ongoing attempt by unions to solve what they refer to as "The Wal-Mart Problem." Although Wal-Mart is, by definition, an oligopolist, if not a monopolist in certain regions of the country, it promotes itself as the ideal "competitor." That is, regardless of its monopolistic position within the retail industry, it promotes the "ideal of competitiveness" – that competitiveness comes through low prices and low prices results from low supply and operational costs. The latter, of course, results from paying the lowest wages in the industry and providing few or no fringe benefits. The effect is that Wal-Mart not only negatively impacts the livelihoods of millions of Wal-Mart employees, it also works to destroy the livelihoods of millions of workers who are employed in the retail industry whose employers are pressured to adopt similar measures to compete.[36] To ensure their competitive edge, Wal-Mart has resisted – so far successfully – the unionization of its employees. However, to challenge this policy and to improve the livelihoods of Wal-Mart employees, the United Food and Commercial Workers (UFCW) has attempted to unionize Wal-Mart. As a result of the united pressures from unionized labor and other fronts such as employee lawsuits involving, among other issues, sex-discrimination in employee remuneration, Wal-Mart

[36] "Up Against the Wal-Mart," *Fortune* (May, 17 2004), pp. 112-120; "Is Wal-Mart too Powerful?" *BusinessWeek* (October, 6 2003)

has announced a new pay system.[37] Despite criticisms from employees and the labor movement, who deem it unsatisfactory, Wal-Mart's new pay system is a response to collective activism. In other words, without the collective pressure coming from several fronts, "The Wal-Mart Problem" would not have entered the public debate and Wal-Mart's lower-than-subsistence wages would have remained unchallenged.

Another example of union mobilization that won workers some favorable concessions was the 170-day strike against nearly 900 Southern California Safeway, Kroger and Albertsons stores beginning in the Fall of 2003. In this case, the corporations aimed to reduce health care benefits. The strike ended with a "…negotiation that preserved employer-paid insurance premiums for the nearly 30,000 workers"[38] of two union districts.

Union activism targets specific entities within the political economic system. Other forms of activism are not so specific and aim at transforming the entire system. For instance, mobilizations such as the demonstrations against the World Trade Organization (WTO) in Seattle in 1999 aim at eliminating global institutions that are responsible for supporting the corporate-dominated global economic system. Whereas the demonstration against the WTO in Seattle did not lead to a reshaping of the corporate-dominated institution, activists agreed that the success in Seattle was their ability to mobilize and demonstrate their power by calling global attention – at least momentarily – to the cause of transforming the global political economic system to favor social welfare.[39]

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[37] "A New Pay Scheme for Wal-Mart Workers," *BusinessWeek* (June 14, 2004), pp. 39

[38] "Southern California Workers Stop Corporate Greed," *Working America* (Spring 2004), pp. 11-14

[39] "How we Shut Down the WTO,"*Z Magazine* (February 2000), pp. 18-19; "Mobilization Against Corporate Globalization: Round II," *Z Magazine* (March 2000), pp. 11-15

Economic and political elites, namely corporations and the politicians they own, have little incentive to change the status quo and in fact, they have garnered all their resources to trump efforts in this regard. However, the benefit of inclusive and effective public participation in corporate governance has the potential to break the systemic inertia that corporations and their political acolytes prefer to preserve and undermine their economic privileges. The direct consequence of active citizen participation is a political economic system that begins to work for citizens rather than reducing individuals to passive consumers that can be easily manipulated by corporate-speak. Active citizen participation in social and political issues can help ensure that the negative externalities of corporate activity are mitigated, that corporations focus on productive activity rather than on pecuniary speculation, and that there is full and accurate disclosure of corporate operations. It is, therefore, my contention that by living "…not only as consumers but as citizens" (Barber 1995: 300), individuals can curtail corporate malfeasance and consequently promote greater social welfare.

6. Conclusion

The objective of this study was to help solve the paradox of public apathy in relation to compelling economic incentive such as the corporate scandals that recently surfaced in the United States. What makes such apathy intriguing and what incited interest in this subject is the understanding that the failure to react to such economic incentives compromises social welfare. This lack of reaction to the recent corporate scandals parallels the failure to react to the malaises of finance capitalism because these episodes are economic phenomena that were nurtured within the contemporary political economic system.

The approach undertaken consisted of pursuing the means that could prevent corporate scandals from happening and identifying which factors are lacking to effect such means. The possible avenues to curtail corporate malfeasance were identified as: a moral transformation; effective government regulation and oversight; and public participation in corporate governance and in the political economic system in general. As the only feasible avenue for reconciling economic incentive and social welfare, I analyzed public participation in particular. The constraints to public participation were analyzed under four topics: (1) the free-rider problem; (2) contentment and conformism; (3) specific knowledge of the corporate world; and (4) the pecuniary mindset that pervades finance capitalism. The results show that all of these are contributive to public apathy, in a way that they are all complementary, especially because different social groups suffer influence from different factors and in different degrees. Table 6.1. below summarizes the effects of these constraints to public participation:

Table 6.1.Constraints to Participation	**Mass Public**	**Shareholders**
Free-Rider Problem	✓	Partial
Contentment and Conformism	✓	✓
Specific Knowledge	✓	Partial
Pecuniarism	NA	✓

According to Table 6.1., the assessment of no-differential gains from participating, conformism to the status quo, and the lack of knowledge to participate in corporate life and in the political economy as a whole impair public participation in overseeing corporate activity and in general directing the political economy. These are critical impediments to social welfare since there is no other viable alternative to fix the system because a moral transformation of the population is unfeasible at this point and government regulation and oversight is ineffective.

Regarding shareholders, contentment and conformism and the pecuniary mindset are central to keep them from seeing that corporations pursue socially responsible socio-economic interactions. Since these factors tend to prevail, knowledge of corporate life among a parcel of shareholders does no good to social welfare.

Perhaps the easiest factor to change among these constraints to public participation and social welfare is knowledge of corporate life. However, as shareholders provide evidence, it does not promote any positive change as far as the pecuniary mindset prevails. Nonetheless, for shareholders such knowledge encompasses a political economic system that benefits them, and for the mass public it would be knowledge of a system that degrades their well-being. In this sense, knowledge of the corporate world and of the impact of corporate activities could promote a reduction in contentment and conformism among the general public. Consequently, informing and empowering the general public with the means to participate in corporate governance and in the political economic system appears to be the most promising avenue for promoting transformations that would enhance social welfare.

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